Labour's pension plan

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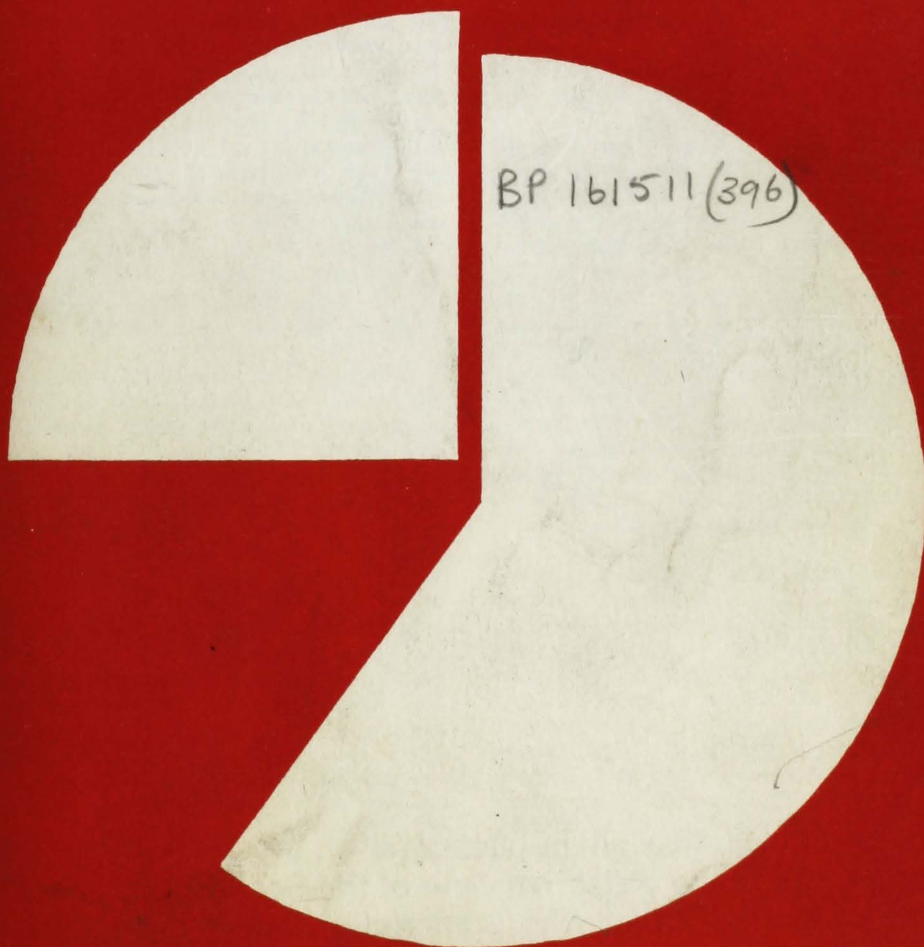

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1. what the plan offers

For once the Government has put forward proposals for legislation in a form which, while committing it to the basic principles, leaves room for public and private discussion of many of the details. In the short time that remains before the White Paper on *National superannuation and social insurance* (Cmnd 3883) is translated into legislation, it is important that such discussion should take place and that it should no longer be limited, as it has largely been so far, to high level negotiation between the Government and the main interest groups—the CBI, the TUC, the Life Offices' Association, and the National Association of Pension Funds. It is also important that the basic principles of the Government's new pension scheme should be understood and discussed. The introduction of the scheme will probably be a major issue in the next general election campaign. Its impact, however, will be still greater in future decades when the standard of living of millions of pensioners will depend on the decisions now being taken.

When the White Paper first appeared, it attracted a good deal of attention in the press. Since then, there has been little serious public discussion, although a further White Paper, *Social insurance* (Cmnd 4124) has been published, giving fuller details of the Government's proposals for earnings related short term and invalidity benefits and showing the proposed contributions and pensions in terms of April 1969 earnings levels (the figures given in *National superannuation and social insurance* were based on April 1968 earnings). (For convenience "the White Paper" means *National superannuation and social insurance,* while "the July White Paper" means *Social insurance*.) This pamphlet takes up the argument from the point at which the initial press reactions left it.

twenty years after

The new pension scheme is planned to commence in 1972. Full pension rights will be earned only by those retiring in 1992 or later. The first question to be asked, therefore, is: what does the scheme offer to those still young enough to derive the maximum benefit from it —men now aged 42 or less and women now aged 37 or less?

The way the basic formula works is, in effect, as follows. The individual's earnings for each year after the scheme commences are expressed as a percentage of average male industrial earnings in that year. These percentages are averaged and it is on the average percentage that the individual's pension is calculated at the following rates:

On earnings up to half the national average: 60 per cent.

On earnings from half to one and a half times the national average: 25 per cent.

Thus a person who, on average, had earned half the national average would get, on retirement, a pension of 30 per cent of whatever average male earnings then happened to be (60 per cent of his individual earnings). If he had earned, on average, one and a half times the national average, his pension would be 55 per cent of average earnings (36⅔ per cent of his individual earnings). Those whose yearly earnings averaged more than 1½ times the national average would get no additional pension.

Once in payment, the pension would be reviewed every two years. As to the amount of the increases resulting from these reviews, the White Paper is less specific. As a minimum, written into the law, the pension would rise sufficiently to compensate for price increases (the possibility of prices falling and the action to be taken in that event are not mentioned in the White Paper, but will presumably have to be covered in the Act). Increases going beyond inflation proofing will be left for decision by the government of the day, taking into account changes in earnings and in the general standard of living, as well as the economic situation.

Two questions arise: the adequacy (or excessiveness) of the pensions at the time of retirement, and the adequacy (or ex-

cessiveness) of the arrangements for post-retirement increases. A third question—whether the redistributive element in the formula is too much, too little, or about right—we shall discuss later, when we have looked at the contribution formula and the proposals for the 20 year transitional period.

meeting minimum needs

The inadequacy of the present flat-rate pension, together with the meagre earnings related benefits under the 1961 Tory graduated scheme, provides the main justification for the new scheme. In particular, having rejected selectivity as a basis for the solution of the long term problems of poverty in old age, the Government is anxious that the pension earned by a low paid worker should be enough to live on without recourse to means tested supplementation. This explains the lower part of the pension formula: 60 per cent of half average earnings in April 1968 came to £6 12s, or enough to raise most single pensioners above the means test limit for supplementary pensions. The July White Paper gives similar figures based on April 1969 earnings. On this basis, 60 per cent of half average earnings is £7 4s. Assuming that supplementary benefit rates continue to rise roughly as fast as average earnings (as they have tended to do for some years past), relatively few people drawing pensions for the first time after 1992 should need to apply for a supplementary pension.

Surprisingly, this aspect of the scheme attracted very little press comment. The *Economist* (1 February 1969) declared it "not proven" that the proposed benefits, even by 1992, would lift people above the need for supplementary pensions. The £6 12s a week which the "lowest grades" of new pensioners would have drawn in 1968 had the scheme started 20 years earlier would, the *Economist* argued, have been less than some pensioners were then getting. This is perfectly true. From October 1968 a single supplementary pensioner was entitled, as a minimum, to £5 1s a week plus an allowance for rent. In November 1968, out of 1,847,000 supplementary pensioners (counting married couples as one), about 575,000 were paying rents of £2 a week or more, and 400,000 were receiving extra allowances for special needs. On the other hand, most of those retiring in 1968 would have qualified for a pension of much more than £6 12s if the scheme had then been in operation for twenty years. Only a small minority would have had to apply for a supplementary pension. Determined to paint as black a picture as possible, however, the *Economist* article continued: "And, of course, by 1992 the official definition of the poverty line will be nearer to the then average wage than £6 12s is to the average wage now". It is indeed possible that the gap between supplementary benefits and wage levels will have been reduced by 1992. Past experience suggests, however, that any such reduction will be small and that the *Economist's* "of course" is a good deal too optimistic. By 1978 the supplementary benefit rate for a single person had risen to 3.6 times the national assistance rate introduced 20 years earlier (excluding the rent allowance and the 10 shilling "long term addition" which replaced many of the discretionary allowances formerly paid by the NAB); while average earnings had risen 3.2 times compared with October 1948. The convention on which recent increases have been based is that laid down in the White Paper for future biennial increases in insurance pensions: inflation proofing as a minimum and increases in line with average earnings whenever possible.

Daily Telegraph readers were given (29 January 1969) a still more alarming view of the future by G. D. Gilling-Smith, who appeared to think that anybody earning less than £1,000 a year would still be liable to have to seek an allowance from the Supplementary Benefits Commission. This suggestion, seemingly based on some quite irrelevant calculations of the value of pensions under the existing scheme, is pure fantasy. On weekly earnings of £20 a week, in terms of 1968 earnings levels, the new scheme gives a pension of £8 17s, for a single person and at least £11 13s for a couple

—far above supplementary pension levels. (Mr. Gilling-Smith is the author of the Pelican *Complete guide to pensions and superannuation* (1967), in which a garbled account is given of the arguments in my earlier Fabian tract *Pension rights and wrongs* (1963), which Mr Gilling-Smith regards as representing "the views on pensions of a small but active group on the extreme left of the Labour Party"!)

So far as the great majority of male employees retiring in 1992 or later are concerned, it is fair to say that the new scheme offers pensions, in the words of the White Paper, "sufficient to live on without other means". But there will inevitably be some who must still depend on means tested supplementary pensions —those with quite exceptionally low earnings or with special needs in retirement (the two will often go together where low earnings are due to disablement), those with particularly high rents (a problem which should be less prevalent by 1992), and those with incomplete earnings records. Earnings will be credited during periods of sickness and unemployment, but prisoners will presumably continue to lose part of their pension rights, as will the growing number of young people who, for varying periods of time, opt out of the system. Jill Tweedie, in the *Sunday Telegraph* (2 February 1969) quoted a mother's reaction: "I suppose this scheme is meant to make you work harder, but I hate that moral pressure—it's another way of clamping you into this productivity mania. Awful for young people, too. They'll feel they can't take two years wandering about, doing odd jobs, living on some Greek island, because they're losing out all the time. More and more, we're becoming just cogs in the wheel— nice, well behaved cogs." For these and similar groups there would be advantages in the device adopted in some other countries by which a few years of lowest earnings (or non-earning) are omitted from the contribution record in calculating the pension. A provision along these lines could easily be incorporated.

If the scheme offers adequate pensions for most employed men, however, it does not offer the same degree of security to single women or to the self employed. It is difficult to see how a wholly wage related pension could meet the needs of the average single woman, given the disgracefully low wages earned by women in Britain. The assumption that nobody in full time work earns much less than half average industrial male earnings may be roughly true for men, but clearly does not hold good for women, whose average full time earnings are about half those of men. For many single women, therefore, a pension of 60 per cent of pre-retirement earnings will not be enough to live on. This is one justification of the decision to pay full earnings related pensions to women at 60, since some at least will be able to earn increments to their pension by deferring retirement for a few years. It should also be noted that, while about 12 per cent of women now reaching age 60 are single, the proportion is expected to fall to about 5 per cent by the year 2000.

As for the self employed, they will contribute on a flat rate basis to earn the full 60 per cent element in the pension, in the same way as an employee earning half the national average wage. But a self employed person with less than half average earnings will not be forced to contribute and, in view of the fairly heavy contributions proposed (27s a week at April 1968 levels), many will prefer not to. It is reasonable to expect that a person who has worked on his own account for many years will normally reach retirement with some private resources to supplement his State pension, but there will inevitably be some of whom this is not true.

meeting needs above the minimum

Granted that the scheme goes a long way towards eliminating the need for supplementary pensions, how much farther than this should it go? Or, to put the question another way, how far should a State pension scheme be concerned with the relationship between pre- and post-retirement income, rather than merely

with guaranteeing an adequate minimum on which individuals or their employers can build?

An interesting feature of immediate press reactions to the scheme was that nobody questioned the case for earnings related pensions, as such. Papers such as the *Daily Telegraph, Daily Express* and *Daily Mail* predictably condemned the whole scheme, but their objection was not to earnings related benefits but rather to the State encroaching on the territory of the insurance companies and occupational schemes. The *Spectator* (31 January 1969) offered an interesting variation on this theme, coming somewhat nearer to a "back to the flat rate" approach. Instead of "the nonsense of graduated benefits", it suggested "an increase in the basic *flat rate* pension to an adequate level, financed by a system of gently *graduated* contributions".

Whatever the theoretical attractions of this idea, it has one major political snag. At present, most employees are paying graduated contributions towards a graduated pension under the 1961 Tory scheme. It is unlikely that any government would be prepared to tell them that in future they would go on paying graduated contributions but with no graduated pension in return. The Tories appeared to be advocating this in 1966, but significantly little has been heard of the suggestion since then. Maybe governments ought to be willing to do this sort of thing, but experience suggests that they are not. A more serious objection to the *Spectator* proposal is that we are not told what is an "adequate level" for the flat rate pension. To provide an adequate income as of right, it would need to be roughly equivalent to the 60 per cent tier of the Crossman formula—at 1968 earnings levels, something over £6 10s a week. Otherwise pensioners with no other resources would still need supplementation. If the increase were only given to retirement pensioners and widows, and not to the sick and the unemployed, it would have cost, in 1968, about £750 millions a year. There is certainly a strong case for improving the flat rate pension, as we shall argue when considering the 20 year transitional period. To do it in isolation, however, as an anti-poverty measure, rather than as part of a wider plan to reduce the gap in living standards between the aged and the working population, would invite the objection that the neediest pensioners—those getting supplementary pensions—were to gain little or nothing, while vast sums of money were to be handed out to the less needy. Would the *Spectator* (which, in the same leading article, has harsh things to say about the improvident and feckless being helped by the State at the expense of the prudent and hardworking) be in favour of raising supplementary benefits for a single man by £2 a week to overcome this objection? If not, the "back to the flat rate" campaign is unlikely to have much of a future.

Among commentators who accepted it as proper for a State scheme to offer earnings related pensions, there was relatively little discussion of the precise formula proposed, nor of the ceiling of one and a half times average earnings above which no additional pension is to be earned. Objections to the ceiling might have been expected from those concerned to extract the maximum contribution from higher paid employees, but the White Paper forestalled criticism on this score by pointing out that only 7 per cent of employees have earnings above the proposed ceiling, and by proposing that there should be no ceiling on earnings in calculating the *employer's* contributions (the ceiling is discussed more fully below). On the benefit side, the maximum pension of £12 2s (at 1968 earnings levels) for a single person probably struck most people as about as much as a State scheme needs to provide, given that most of those for whom this would be a reduction of income would be covered by occupational schemes.

post-retirement increases

When the original Labour Party policy statement, *National superannuation*, appeared in 1957, careful readers were able to detect significant differences between

the model scheme drawn up by the party's academic advisers and published as an appendix, and the scheme actually adopted as party policy. In particular, there had clearly been some difficulty in reconciling academic enthusiasm with political caution on the extent to which pensioners could be promised increases in their pensions after retirement. (This question is dealt with, both in relation to the Labour Party proposals and more generally, in the final chapter of my book *French pensions* (G. Bell and Sons, 1967).)

Similar difficulties seem to have afflicted the authors of the White Paper. They could of course have left the matter open. Pension increases in the past have been awarded on an *ad hoc* basis with no prior commitment as to either timing or amount. But there were compelling political reasons for including a definite undertaking of some kind. Not only *National superannuation* but subsequent policy statements had committed the Labour Party firmly to automatic periodic adjustment of pensions in payment. Moreover, the existing *ad hoc* arrangements had developed over the years into a fairly clear conventional pattern: increases every two years (more or less), at least sufficient to maintain the real value of the pension and, in practice, maintaining or improving its value relative to average earnings. Finally, the logic of a pay as you go scheme, with earnings related contributions whose yield would rise automatically in proportion to any increase in average earnings, pointed clearly to a similar automatic increase in pensions. This logical connection is explained clearly in the White Paper (paragraph 45) and will be discussed later in this pamphlet.

The case for tying pensions to an index of average earnings, however, does not rest mainly on either political expediency or mathematical logic. If pensions do not rise, after award, roughly as fast as earnings, the gap in living standards between the pensioner and the working man will gradually widen. As the demands on his income grow with the rising standards of the community, the pensioner will sink steadily into a poverty that is no less real for being relative. If the initial level of pension was really generous, this gradual falling behind might not cause much hardship; but the decision which faced the Government was not wholly or even mainly about how the more generous new scheme pensions would be adjusted after award—it was also about the treatment of existing flat rate pensioners and those retiring in the early years of the new scheme.

The White Paper, in a chapter on basic objectives, acknowledges "the need for pensioners to share in the nation's rising living standards". Pensions must therefore not only reflect changes in earnings levels during the contributor's working life; they "must be adjusted regularly for further economic changes which take place during retirement. In both cases adjustment is needed not only for changes in price levels, but also for changes in general living standards". And the White Paper goes on to show that, while prices more than trebled between 1922 and 1968, the real purchasing power of average earnings nevertheless more than doubled; so that a pension tied to an index of earnings over that period would have been worth twice as much by 1968 as if it had been tied to a price index.

Having thus convinced us of the need for pensioners to share in the rising living standards of the community, the authors of the White Paper suffer a loss of nerve in the next chapter, which announces that the Government will be bound by statute to review the main rates of benefit every two years and to increase them by at least enough to compensate for any rise in *prices*. The wording of the relevant paragraph suggests that there is a definite intention to give increases going beyond this, so that pensioners will "continue to share in the nation's rising living standards". But this will not be a statutory obligation and the factors to be considered in deciding on the improvement on each occasion will include "the general economic situation". In other words, any increase going beyond price changes will be subject to a Treasury veto.

This, one might have thought, was hardly a major advance. It simply committed the Government to do, as a minimum, less than it had already being doing in practice. Yet both *The Times* and the *Economist* were worried about it. "The safeguards against inflation", *The Times* (29 January 1969) suggested, "may seem a dangerous commitment. As the scheme will be pay as you go, as opposed to funded, this will involve earmarking a significant proportion of the income of future wage earners for the welfare of that generation of pensioners". While conceding the case for inflation proofing in terms of social justice, *The Times* concluded that "all these issues hinge on the question of cost". In fact, of course, inflation proofing, does not increase the real cost of pensions; it simply ensures that their actual purchasing power will not be eroded. And it is precisely the fact that this is to be a pay as you go scheme that makes possible not only inflation proofing but the linking of pensions to an earnings index without any danger to the financial stability of the scheme.

The *Economist*, too, in its "Business Brief" (1 February 1969) failed to grasp the immense advantage that a pay as you go scheme can have in giving post-retirement pension increases. "A pension which can be adjusted for changes in living standards", it commented (apparently unaware of the history of national insurance since the war), "is a major breakthrough in social welfare terms. In terms of insurance, however, it is an actuarial nightmare". In terms of *private* insurance, this may be true—though it is about time that actuaries and insurance companies stopped regarding inflation as an uninsurable risk (anybody would think they had never heard of investment in equities). But for a pay as you go *social* insurance scheme, tying pensions to changes in living standards is not a nightmare but a simple, self balancing operation.

The *Economist's* main attack, however, in a leading article in the same issue, was not directed to the imaginary technical difficulties but to the economic dangers of the commitment to inflation proofing, which it described as "the one utterly irresponsible section of the White Paper . . . It is no good saying that in practice pensions always have eventually been raised in line with national living standards. Governments hitherto have been able to choose their moment—and their choice would not normally fall on every other autumn, the moment when, from past experience, sterling generally is subject to its greatest seasonal strain and when annual wage bargaining is apt just to be rising to its inflationary peak".

How real is this danger? Whether it is real or not, it is hard to imagine, after the outcry over the Labour Government's decision at the end of 1964 to raise benefits in the spring, that any future increase will be given at a time of year other than autumn or early winter. But it really does not seem likely that the automatic fulfilment of a statutory obligation every two years would have a catastrophic effect on international confidence in sterling. On the contrary, the *ad hoc* increases given in the past (of which the 1965 increase is a prime example) were far more likely to produce such effects. And if the Government was particularly anxious to give an impression of financial caution on the occasion of a biennial increase, it could do so (though one hopes it never would) by limiting the increase to the statutory minimum required to match price increases. The *Economist's* fears therefore seem entirely groundless. It surely ought to have welcomed this aspect of the scheme as a way of at least partly removing periodic pension adjustments from the political arena.

One other aspect of the adjustment of pensions in payment attracted critical attention from the National Association of Pension Funds (NAPF), whose Vice-Chairman, Mr E. F. Rogers, was quoted in the *Guardian* (30 January 1969) as saying that it was a "gross injustice" that pensions payable under the present graduated scheme were not to be included in the biennial reviews. The NAPF, a body mainly representing non-insured private pension funds, urged that "graduated pensions should be lumped with other

State pensions for this purpose in accordance with promises made when the graduated scheme was introduced" (*Post Magazine and Insurance Monitor,* 6 February 1969). Just what these promises were and to whom they were given is a mystery, but the NAPF must have been well aware that there were very good reasons for omitting the Tory "swindle" pensions from the biennial reviews (as they have been omitted from pension increases throughout the 1960s). When the graduated scheme was introduced, the Tory government was particularly anxious to enable private schemes to contract out. Believing that contracting out would only work if the graduated pensions offered by the State scheme were of a kind which private schemes could match, it made no provision for post-retirement increases of pensions. But once employers have been allowed to contract out on the basis that all they need provide is a pension fixed in advance and unrelated to movements in prices and incomes, they can hardly be required to match subsequent improvements in State pensions by retrospectively increasing the value of pension rights already accrued in their schemes. To include pensions from the present graduated scheme in the biennial reviews would thus be unfair on employees who had been contracted out and therefore could not share in the resulting increases. Despite the unfairness, however, the Government has now had second thoughts on this point. Mr Crossman informed the House of Commons on 10 June 1969 that the present graduated scheme was, after all, to be "dynamised", so that after 1972 the sixpenny units of pension earned under it would be reviewed every two years in the same way as pensions earned under the new scheme. The reason for this change of mind was that the Government, faced with the need for a substantial increase in contributions in November 1969, had decided to place part of the increase on the graduated contribution, thus expanding the Tory "swindle". To justify this, it felt obliged to offer benefits in exchange that would at least be protected from inflation. By doing so, however, it has created an unfair discrimination against contracted out employees, whose occupational pensions will remain fixed in cash terms throughout their years of retirement. If can, of course, be argued that the benefit to the majority outweighs the injustice to a minority, but this is a dangerous argument. The whole episode demonstrates the fundamental inadequacy of the Tory graduated pension scheme and the need to replace it with a scheme offering dynamic pensions to all, whether contracted out or not.

the new deal for women

A central feature of the White Paper's proposals is the emphasis they place on provision for women. Pension schemes tend to be judged primarily by the benefits they offer to men retiring after a lifetime of work at a rate of pay within the normal range of male earnings. Yet most pensioners are women and it is among them that poverty in old age is mainly found. The poorest of all, as a group, are widows, nearly half of whom receive supplementary benefit; and the White Paper estimates that, if supplementary benefits were raised by £1 a week well over 80 per cent of widow pensioners over 60 would qualify. Most married women pensioners get only the £2 16s flat rate pension on their husband's insurance and perhaps a few shillings from the graduated scheme. If they have paid enough contributions to qualify for a full pension of £4 10s in their own right, the extra £1 14s is poor value for money, and the flat rate contribution is a heavy burden for most women employees. For these reasons, married women at present can choose not to pay flat rate contributions, except for industrial injuries. Single women, however, do not have this option.

The new scheme offers a much better deal to women and it is typical of the male dominated approach to pension problems that the press had little to say on this subject. The *Guardian* (29 January 1969) noted that "Working women come out of the proposals particularly well. They should encourage many more women to return to full time work when their children are off their hands". And

the *Economist* (1 February 1969) in an otherwise almost entirely hostile review of the scheme, said, "it deserves particular praise for its provisions for working women and widows", and was even prepared to condone the "bias towards the lower paid" on the grounds that "it will largely help working women, who are discriminated against in more commercial schemes".

The main features of the new deal for women can be summarised as follows:

1. Abolition of the flat rate contribution will particularly benefit women, and makes possible the removal of the married woman's option. In future all women employees will contribute a percentage of their earnings like men.

2. Women will continue to qualify for pension at age 60, five years earlier than men. Nevertheless, and despite their greater expectation of life, they will draw a full pension at 60 on the same basis as a man's pension payable at 65 (an important change from the present graduated scheme which offers smaller pensions to women). This should give the average single woman a reasonable prospect of earning a pension on which she can live without means tested supplementation, although some women will have to continue working for some years after age 60 to earn a pension above the means test level.

3. Married women will be sure of getting some additional benefit in return for any contributions they have paid. The existing flat rate married woman's pension will remain, but a pension of 25 per cent of her average earnings (calculated in the same way as for men and single women, but without the preferential 60 per cent rate on the lower band of earnings) will be added. This, however, is a minimum. If the pension earned by her own contributions, applying the normal 60 per cent/25 per cent pension formula, is greater than that arrived at by the first method, she will simply get her own pension as if she were a single woman. Eventually, the normal situation will be that husband and wife will each have a pension based on their respective contribution records.

4. Widows will normally get a pension based on the whole of their husband's entitlement, that is, either the pension he was drawing, or had earned, prior to his death or, if he died before reaching age 65, the pension he would have been entitled to at that age, earnings for the intervening years being credited at half the national average. From age 60, a widow will be able to substitute her own contribution record if that would produce a bigger pension than her husband's. To allow a widow to inherit the whole of her husband's pension is far more generous than the provision for widows in most countries' social security schemes and compares very favourably with the widows' benefits (if any) generally offered by occupational schemes. It earned the approval not only of the *Economist* but of other commentators, whose reactions to the scheme as a whole were decidedly unfavourable. The *Spectator* (31 January 1969) described it as "clearly right" and even the Tory spokesman, Lord Balniel, welcomed these improvements.

One suggestion which the White Paper rejects is that married women should be enabled to build up their own pension entitlement without having to depend on their husbands' contribution record, by crediting contributions to housewives in the same way as is done for the sick and unemployed. The two objections mentioned are the difficulty of deciding under what circumstances a woman should be regarded as a housewife, that is, not available for paid work, and the fact that, if the resulting pension were adequate for a widow, it would be excessive for a married woman whose husband was still alive. While these objections may not seem particularly cogent, it is certainly true that, once adequate provision is made for widows, the question of how far women's pension rights are derived from their husbands' contributions seems somewhat academic. The proposals for widow's pensions in the White Paper are in fact more generous than would be produced by a system of credits for housewives.

2. paying for the plan

The proposal to do away with the flat rate contribution and substitute a single proportional contribution was generally well received. Even the *Spectator* (31 January 1969), despite its opposition to "the nonsense of graduated benefits" was in favour of graduated contributions in place of "the inequitable flat rate stamp". Mr Arthur Seldon, writing in the *Sunday Telegraph* (2 February 1969) took a different view of "the notion of graduating contributions, with which Mr Crossman's academic advisors have befuddled him", but his objection seemed to be to graduated benefits rather than graduated contributions as such.

If the principle of graduation was accepted as more equitable than the flat rate system, however, there was considerable concern at the actual size of the proposed contributions and the possible economic effects of introducing them. The July 1969 White Paper, *Social insurance,* suggests that the total employees' contribution for pensions and other benefits may, in the event, have to be even higher than the 6¾ per cent of earnings proposed in the earlier White Paper. The increases in November 1969 will, it is true, bring the contributions to the present scheme some way towards the level required in the new scheme, thus making the transition somewhat less abrupt. Yet the fact remains that the changeover from partially flat rate to wholly graduated contributions will bring relatively small comfort to the lower paid worker. On earnings as low as £12 a week, even allowing for the November 1969 increases, his contribution will fall by only 4s 7d (from 20s 9d to 16s 2d) in 1972; and, as the scheme goes into the red after the early years of surplus, the burden on the low paid worker will rise to at least its present level. As Lord Balniel pointed out in the *Sunday Times* (2 February 1969), the promise that the average earner would pay no extra contribution in the new scheme had gone by the board.

Far more concern was expressed, however, about the inflationary effect of extracting increased contributions from the higher paid than about the disappointingly small reductions for the lower paid. The *Spectator* saw the whole scheme as a "series of hoaxes, woven together in a system of immense and totally unnecessary complexity, simply to try and persuade people that the higher taxes are not really higher taxes at all". The *Financial Times* (29 January 1969), less hysterically, warned that the scheme's success would depend on "whether the better off wage earner is prepared to save for the future, and save in this particular form, or prefers to regard the increase in contributions as a form of taxation to be met by less saving of other kinds and demands for higher pay". Mr Arthur Seldon, writing in the *Sunday Telegraph* (2 February 1969) unhesitatingly adopted a pessimistic view. Employees would not ask for higher pay if the ICI pension scheme were enlarged; but, said Mr Seldon, the State scheme is different. "People in a private scheme are more likely to feel they are paying for something *out of* their earnings; compulsory contributors to a State scheme would regard the additional contribution as a tax *deducted from* their earnings, especially as it will be paid with PAYE"; and, he added, they would be right because in a private scheme their money is "always there, invested in a fund" while in the State scheme it is "spent and long forgotten when the time comes to draw the pension".

It is odd how Mr. Seldon's pen translates "people" in a private scheme into "compulsory contributors" to a State scheme, as if private schemes were not compulsory for the majority of their members. And it is equally odd, if true, that people should have more faith in a private pension fund subject to all the hazards of the investment market over several decades, and offering little if any protection from inflation after retirement, than in a pay as you go State scheme in which contribution income will automatically rise with earnings, thus ensuring (short of sudden and catastrophic changes in the age structure of the population) that the standard of living of pensioners can be maintained in relation to that of the working population. If anything, one might expect that employ-

ers would be more likely to face wage demands as a result of increases in contributions for which they were themselves responsible than as a result of increases imposed by the Government. There is certainly no evidence that higher social security contributions in the past have had any measurable effect on wage levels.

Nevertheless, this is clearly a danger to be watched carefully; the more so since it could result in greater inequalities in wages and salaries by inciting the higher paid to extravagant demands. Experience of the Government's incomes policy in recent years inspires little confidence that such demands could be effectively resisted. Having said this, however, one must add that the success of the scheme, *as a pension scheme*, does not depend on whether or to what extent its effects are inflationary. In this it differs fundamentally from a funded private scheme, whose solvency can be seriously undermined by inflation and which can never offer pensioners complete protection from rising prices. The effect of inflation on the national superannuation scheme would be to produce an automatic and self balancing increase in both contributions and pensions. Inflation may be undesirable in terms of the national economy as a whole, but it would not threaten either the viability of the scheme or the standard of living of pensioners (apart from the interval of up to two years which could elapse between a price increase and the next biennial review of pensions). And, finally, we may note the view cautiously expressed by Frances Cairncross in *The Times* (29 January 1969): "A very rough and qualified estimate suggests that [the scheme's] *deflationary* effect in the first year of operation will be in the region of £200 million to £250 million at 1966 prices" (my italics).

the fund

The White Paper proposes the creation of a National Superannuation Fund which, in the early years of the scheme, will accumulate a surplus. We are not told how this surplus will be invested. In particular, there is no mention of the proposal made in the 1957 *National superannuation* document that the fund should be invested like a private pension fund in industrial shares and other non-government investments.

The *Guardian* (29 January, 1969) was critical of the decision to drop this idea, pointing out that the National Insurance Fund had lost £40 millions in ten years through investing in depreciating government stocks—and to this loss must be added the gains forgone by not investing in equities. On 31 January 1969, both Peter Jenkins in the *Guardian* and Woodrow Wyatt MP in the *Daily Mirror* argued that the change of heart on equity investment was a major departure from the 1957 policy. Mr Wyatt wrote enthusiastically about the opportunities for "back door nationalisation" offered by the £3,000 millions surplus (assuming no contracting out) shown by the Government Actuary's figures for 1987, while Mr Jenkins recalled that this had been one of the original scheme's attractions to "revisionists in the party who wanted to bring about an extension in the public ownership of wealth without resort to cumbersome, old style nationalisation".

Whether it would necessarily be a good thing for the Government, through its pension fund, to acquire minority shareholdings in a variety of industrial and commercial undertakings may fairly be questioned. It would be a mistake, however, to regard the decision to abandon this proposal as a retreat from one of the major principles of the scheme. Even if there were no contracting out, the fund would reach its maximum size in 1987-88, after which contribution rates would have to be increased simply to meet the current expenditure of the scheme, and there would be no further surplus for investment. The effect of contracting out would be to advance still farther the time when the fund would cease to grow. From that time on, the scheme is to operate on a pay as you go basis, and the question of investment in equities, government securities, or anything else, will cease to be of great importance. It is true that a fund invested

profitably could provide a useful subsidy to the scheme but, unless it was much larger than seems likely, the difference this would make to the contribution rates would be relatively small.

The pay as you go method of financing pensions—paying for each year's benefits out of the same year's contributions—has come to be regarded as somewhat disreputable by comparison with the funding methods adopted by insurance companies and private employers. The belief that funding is in some way morally superior is reflected in the frequently used term "a properly funded scheme"—the clear implication being that pay as you go schemes are improper. Thus, the *Economist* (1 February 1969) urged that all workers below middle age should be in "adequate, properly funded, savings generating, transferable pension schemes" and that, for those not adequately covered in private schemes of this sort, there should be a "properly funded" state superannuation scheme, invested in equities. Since this would mean that contributions to the new scheme would not be available to meet the cost of existing pensions, the *Economist* proposed that there should be an additional social security tax payable by employers and employees. In other words, the present working generation would have to pay not only for its own pensions but for those of the previous generation as well. To make this double burden more tolerable, the *Economist* suggested that, after a certain period, new pensioners should have to go through a means test if they were to draw out more than they had "actuarially" paid for.

The sheer unreality of the *Economist's* proposals should be enough to dispose of the case for operating the state scheme on a "properly funded" basis. To reduce the pensions of people who have contributed for all or most of their working lives by reference to some hypothetical "actuarial" formula might make sense to a commercial insurance company, but to ordinary people it would seem like a confidence trick. Even if this were done, however, it would have no immediate effect on the level of expenditure on pensions, since it would not apply to those already in payment. So the *whole* cost of the new scheme would be an additional burden on employers, insured persons and the Exchequer. The total contributions to the old and new schemes would be far greater than those proposed in the White Paper—and calling part of the contribution a social security tax would not make it any more tolerable.

But this is not the only argument against bringing commercial ideas about funding into the State scheme. Advocates of funding tend to suggest that it makes for greater stability and security, while a pay as you go scheme offers no assurance that the obligations undertaken now will be honoured 30 or 40 years ahead. This is the opposite of the truth. Nobody can predict with any confidence what a pension fund will be worth or what rate of interest its investments will yield even a few years ahead. One may hope that, through investment in equities, the fund's investment income will grow at least as fast as average earnings, thus enabling pensions to rise in line with an index of earnings; but one certainly cannot assume that this will happen. What, for instance, is the likely effect of incomes policy on company profits in the future? It is tempting to answer "None", but who knows?

In a pay as you go scheme, on the other hand, there is a direct link between the level of earnings and the contribution income out of which the current pension bill has to be met. As paragraph 43 of the White Paper puts it: "Since the new scheme's contributions will be earnings related, the income they produce will automatically rise with the higher earnings levels which can be expected to accompany economic growth. In this way the new scheme, with its earnings related contribution income, will be able, without imposing an excessive burden on future generations of contributors, to give pensioners and other beneficiaries not only protection against the effects of price increases but also a share in the general improvement of the nation's living standards." It is true that the precise rate of contribution necessary in a pay

as you go scheme may be affected by unexpected changes in the age structure of the population. If, in the year 2002, the number of pensioners, as a proportion of the working population, turns out to be higher or lower than is assumed in the Government Actuary's estimates, the combined contribution rate needed to pay for pensions in that year will be correspondingly higher or lower than the 11.4 per cent shown by the Government Actuary in appendix 2 of the White Paper. Similarly, variations in the numbers contracted out (not allowed for in the Actuary's figures) would affect the contribution rate required. But these are factors which can be predicted and which are unlikely to change suddenly or unexpectedly. On balance, therefore, pay as you go financing offers a far greater degree of security for future pensioners than does funding.

Even the *Economist* does not really believe that the State scheme should be *fully* funded. What that journal understands by a "properly" funded scheme, as it frankly admits, is merely a scheme which "should run for the next 20 years a sizeable annual surplus". A fully funded scheme would produce a substantial annual surplus for half a century or more. What the *Economist* implicitly (though not explicitly) demands, therefore, is a scheme which pretends to be "properly funded" but which operates with contribution rates far below the level needed to build up an adequate fund in actuarial terms. Precisely how this can be reconciled with its suggestion that the new scheme "should involve slightly more onerous terms for employers than they could usually get through the commercial market" is not explained—but presumably not by giving specially favourable treatment to the low paid and to those nearing retirement at the commencement of the scheme, since the *Economist* criticises the Government for spending money on these "social twists" which should have gone into a savings fund.

It is perhaps unfair to criticise the *Economist* too harshly for an off the cuff reaction to the White Paper which, when examined at leisure, turns out to be impractical nonsense. In fairness one must admit that the *Economist* showed an infinitely better grasp of the issues than did *The Times,* which carried a leader (29 January 1969) consisting largely of fanciful arguments in favour of private funded schemes, so divorced from reality as to suggest political motives unworthy of a once great newspaper. One argument used by both the *Economist* and *The Times,* however, demands serious consideration—that the Government's proposals represent a move away from occupational schemes which are "savings generating" to an unfunded State scheme, which is not. Just how true is this and, if true, how important?

There can be no doubt that occupational pension schemes are an extremely important channel for personal savings, accounting at present for "more than one third of total personal savings and more than a tenth of total net savings" (White Paper, paragraph 121). To wind these schemes up and substitute an unfunded State scheme would inevitably result in a catastrophic fall in personal savings. But that is not what the Government proposes. Employers are to be allowed to contract out of part of the new scheme on terms which, though still under negotiation at the time of writing, seem likely to encourage the continuation of existing occupational schemes and, in all probability, the creation of new ones for employees not at present covered. Some private employers will no doubt decide to wind up their schemes or modify them to fit on top of the State scheme, reducing the volume of savings through occupational schemes. Against this reduction, however, must be set the surpluses, those are the savings, predicted by the White Paper for the early years of the new scheme. It is impossible to predict whether, on balance, there will be an increase or a reduction in personal savings on the introduction of the scheme, but it seems unlikely that any substantial reduction will occur at first. Later on, when the state scheme no longer produces an annual surplus, the volume of savings may be lower than if the scheme had not been introduced. But equally, as

has happened before, the promise of a reasonable minimum income on retirement may stimulate voluntary savings for the purpose of supplementing the benefits of the state scheme. Moreover, as private schemes mature, they too will cease to accumulate funds at the same rate as in their early years when the number and size of pensions in payment were small.

Even if, in the long run, some reduction in savings occurred, it need not be regarded as a disaster. The importance attached to restraining private expenditure as an aim of economic policy varies over time (as recently as 1963, national insurance benefits were raised with the object of stimulating private spending), and our present obsessive pursuit of this aim is not a valid basis for long term social policy making. At the best, increased personal savings are an incidental by product of a funded pension scheme. Its central objective must be to provide adequate pensions, and one result of funding is to postpone the achievement of this aim. It is worth considering, therefore, whether the White Paper goes far enough in adopting pay as you go methods. This brings us to the crucial question of the effect of the Government's proposals on those already retired or due to retire in the early years of the scheme.

3. the transition

When a new contributory pension scheme is introduced, the question inevitably arises: what, if anything, is to be done for those who are already too old to contribute to the scheme? Are they to be given pensions even though they have not contributed? If so, how large should their pensions be? If the reason for introducing the scheme was, partly at least, dissatisfaction with the low standard of living of the generation now in retirement, it is obviously desirable that they should derive some benefit from it. Yet it is difficult to treat them as generously as later generations who will have paid contributions for 40-50 years.

The difficulty is greater in a scheme giving earnings related pensions than in a flat rate scheme. If the elderly are awarded flat rate benefits on generous terms, it can at least be argued that, as a generation, they have created the wealth on which present standards of living are based, just as much as if they had contributed to the pension scheme. But it is harder to justify paying them earnings related pensions for which they have not contributed. Why should one man get a higher pension than another if neither of them has paid into the scheme, or if both have paid the same flat rate contributions?

In the White Paper, this dilemma appears in two forms. First, a decision had to be made as to the length of the transitional period during which new pensioners would get something less than the full earnings related benefits promised to those retiring when the scheme was fully mature. Secondly, there was the problem of those already retired on flat rate pensions (supplemented in some cases by a few shillings a week from the Tory graduated scheme), to whom it would be difficult if not impossible to pay additional earnings related pensions for which they had not contributed. Higher pensions for this group meant higher *flat rate* pensions, and the Government therefore had to decide whether and by how much the existing flat rate pension should be increased.

In a scheme operating on purely commercial principles, nobody would draw a full pension who had not contributed to the scheme throughout his or her working life (subject to any age rules, such as that nobody under 25 could join the scheme). The Labour Party's original national superannuation scheme was based on this principle, though it offered particularly favourable terms to those within 20 years of retirement age by doubling the pension value of contributions paid from age 45 compared with those paid between 25 and 44. The 1963 policy statement, *New frontiers for social security,* went farther by redoubling the value of contributions paid by those nearing retirement in the early years of the scheme, so that a married man with average national earnings retiring only seven years after the scheme commenced would draw a half pay pension.

The White Paper approaches the problem in a slightly different way. First, it lays down the levels of pension to be achieved once the scheme is mature—that is, how much pension a person who has contributed from the age of 18 should get on retirement. Having done this, it departs from commercial principles by saying that pensions of this magnitude should be paid to those retiring after the scheme has been in operation for 20 years. Thus, if the scheme commences in 1972, those retiring in 1992 or later will get pensions calculated in the same way as if they had contributed to the scheme for 47 years in the case of men and 42 for women. Having decided on 20 years as the period of gestation before full earnings related pensions come into payment, the White Paper neatly proposes that those retiring during this period should get a proportion of the benefits of the new scheme corresponding to the number of years they have contributed to it. Thus, a man aged 60 in 1972 will be able to retire five years later and draw a pension consisting of 5/20ths of his full entitlement under the new scheme and 15/20ths of his entitlement under the old.

These proposals can be regarded as a compromise between two kinds of unfairness. First, there is the unfairness of

paying full earnings related pensions to people who have paid earnings related contributions for only part of their lives. So far as the lower paid worker is concerned, the bargain may not be as favourable as it seems, since he is already paying bigger contributions than he will have to pay in 1972. The higher paid, however, will do very well out of the accelerated build up of pension in the early years. To some extent, therefore, this may be seen as a transfer from poor to rich—though it should also be remembered that the pension formula is weighted against the higher paid worker. How far it is right to advance the maturity date of the scheme and thus offer specially generous terms to the present generation of higher paid middle aged employees is a matter of judgment. Twenty years, however, seems a long enough period to counter the charge of unreasonable generosity to the higher paid, which would certainly have been voiced had the gestation period been only five or ten years. In the event, none of the press commentators suggested that the proposed transition was too short.

unfairness between generations

But there is also the opposite kind of unfairness resulting from the differing treatment of different generations. As *New Society* (30 January 1969) put it: "The morality of the present generation of workers promising itself generous pensions at the expense of the following generation, while refusing to give comparably generous treatment to those already retired, is extremely dubious." In a funded commercial scheme, in which each generation can be said to pay for its own pensions, this objection would have less validity. It is the fact that the new scheme is to be financed on a pay as you go basis that makes the contrast between the generations seem particularly unfair. We have already noted the fact that, in a pay as you go scheme, the higher contribution income resulting from increased earnings makes possible corresponding increases in benefits. By the same token, a contribution rate (expressed as a percentage of earnings) which will meet the cost of half pay pensions on a pay as you go basis in 2020 would also be sufficient to pay for half pay pensions now, assuming no significant change in the relative numbers of contributors and pensioners. The logic of pay as you go, carried to its conclusion, suggests that from the inception of the scheme all pensioners, including those who never contributed a penny to it, should get pensions calculated in precisely the same way as if they had contributed for the whole of their working lives—and this argument is particularly cogent in relation to the low paid worker whose present contributions are higher than they will be under the new scheme. Anything less implies that those now of working age are not prepared to do for their parents what they are virtually compelling their children to do for *them*. The point is clearly illustrated by the Government Actuary's table in appendix 2 of the White Paper, showing the total contribution rates needed to pay for pensions (old and new combined) during the first 30 years of the scheme, assuming no contracting out.

CONTRIBUTION RATES NEEDED TO PAY FOR PENSIONS

year	%
1972-73	7.7
1977-78	8.4
1982-83	8.9
1987-88	9.7
1992-93	10.4
1997-98	11.1
2002-03	11.4

Even in 2002-03, some older pensioners will not have qualified for full pensions under the new scheme, and the contribution rate will continue to rise slowly for some years. A genuine pay as you go scheme, based on parity of treatment as between the generations, would have to *start* with a joint contribution to the National Superannuation Fund of about $12\frac{1}{2}$ per cent of earnings, thus enabling full pensions to come into payment at once.

Justice as between the generations, however, as we have seen, is not easily achieved at the commencement of an

earnings related scheme, even if the contributors are willing to foot the bill. If it is accepted that earnings related benefits can only be introduced gradually, the only way in which existing pensioners can be given any substantial benefit from the new scheme (apart from the introduction of new benefits related to age or disability, as suggested by Peter Townsend—see below) is by a flat rate increase. That earnings related benefits *can* be introduced without a long gestation period is proved by the recent development of "complementary" pension schemes, administered jointly by employers and trade unions, in France, where pay as you go methods have been adopted in a thoroughgoing way and with impressive results (see T. Lynes, *French pensions,* 1967). But it is hard to imagine this happening in a statutory State scheme in Britain. Paradoxically, therefore, in judging how far the new earnings related scheme is fair and equitable, given its pay as you go financial basis, one must look first not at the benefits emerging from it when it reaches maturity but at its immediate impact on the old flat rate scheme.

effect on existing flat rate scheme

On this crucial question, the White Paper is carefully non-committal. We are simply not told what increase, if any, existing flat rate pensioners can expect to receive in 1972. "The rate to be paid to present scheme pensioners," paragraph 5 states, "when the new scheme starts will be decided by the Government at the time". Having thus left the matter open, however, the White Paper proceeds on the implicit assumption that, apart from normal adjustments to maintain the value of the flat rate pension relative to average earnings, of which the November 1969 increase is an example, no further increase whatever will occur. The fact that the Government Actuary's costings in appendix 2 are based on this assumption is not, in itself, particularly significant, since any other assumption would have been taken as a firm commitment to whatever increase was assumed. But what is one to make of chapter 7, in which the financial and economic implications of the new scheme are discussed? The possibility of a once for all increase in the flat rate pension in 1972 is not even mentioned. The reduction of the gap between the living standards of the working population and the retired population, we are told, "will come about gradually", which hardly suggests that any radical change is expected at the commencement of the scheme. Similarly, in discussing how long the scheme is likely to show a surplus of income over expenditure, the White Paper lists, as the most important factors to be taken into account, "the extent to which, over the years, the growing national income will permit improvements in the real value of pensions after award; the arrangements for contracting out; and the number of employees covered by these arrangements". A substantial increase in the flat-rate pension in 1972 could have a greater effect on the size and duration of the surplus than any of these factors; yet it is not mentioned.

Given these facts, the Government can hardly complain if people draw the obvious inference that existing pensioners are to get nothing out of the new scheme except the periodic increases which they have already come to expect as a matter of course (indeed, it seems more than probable that, after the increase in the autumn of 1969, they will have to wait until 1972 for any further increase at all). Richard Sleight, writing in the *Policy Holder* (7 February 1969), was highly critical of the White Paper for first analysing the plight of today's seven million pensioners and then offering "a solution to the problem which does not make the slightest difference to any of them". "If the new State scheme were funded," Mr. Sleight continued, "there would be some excuse for leaving present pensioners out in the cold; not, of course, on social grounds, but because of the prohibitive cost. But where financing is on a pay as you go basis . . . the argument from prohibitive cost falls by the way."

The *Guardian* (29 January 1969) re-

garded the failure to do anything for existing pensioners as the most serious weakness in the proposals: "There is a real danger of an ever widening gap between their pension standards and those of people coming into the wage related scheme. It is not good enough to say, as the White Paper does, that 'They will continue to share in the nation's rising living standards, through periodical increases in their pensions'. Many thousands of these old people will be still alive when the rest of us are, hopefully, drawing our wage related, inflation protected pensions in the 1990s. The Government should commit itself to something more definite to see that existing pensioners, as well as those of the 1990s, are taken out of the Poor Law era." And in the same issue of the *Guardian,* Peter Townsend suggested what that "something more definite" should be: the basic pension should be raised by 30 per cent from £4 10s to £5 17s, and either an age supplement for single and widowed persons or a substantial disability pension should be introduced.

There is room for discussion as to what would be the most effective way of giving the present retired generation a share in the higher standards of living which the new scheme promises for future generations. Since the White Paper ostensibly leaves the whole question for discussion when the time comes (in 1972), there are grounds for hoping that such discussion will lead to effective action. It is obvious that, in the drafting of the White Paper, strong pressures were exerted in the opposite direction. It is precisely the fact that no immediate increase in expenditure is promised that enabled Mr Crossman to sell his scheme to the Treasury. As Richard Sleight wrote in the *Policy Holder,* the Chancellor was "more anxious to find new sources of State income in his next budget than to find new ways of spending the money" (in fact, of course, it is the 1972 budget that will reap the bonus of the new earnings related contributions), and Mr Crossman therefore had to perform the "political conjuring trick" of devising a scheme which would "produce large extra benefits at no extra cost".

One can only hope that by 1972 the needs of the aged and the demands of equity will take precedence over the performance of political conjuring tricks.

4. redistribution

". . . the scheme will be heavily redistributive . . . Can our uninspired economy really afford yet further equalisation and redistribution of earned incomes?" (*Daily Telegraph,* 29 January, 1969).

" . . . yet another example of that redistributive taxation from which we already suffer too much." (Mr John Boyd-Carpenter, MP, reported in *The Times,* 30 January 1969).

" . . . the plan does not redistribute income to any great extent." (David Watt, political editor, *Financial Times,* 29 January 1969).

"The bias towards the lower paid is smaller than was proposed in earlier Labour documents. It will largely help working women, who are discriminated against in more commercial schemes. It should not be too strongly attacked." (*Economist,* 1 February 1969).

"Was it really not possible to introduce a more radically redistributive scheme with some flat rate element in the benefits?" (*Guardian,* 29 January 1969).

There are a number of ways in which a pension scheme can be "redistributive" and there is therefore no simple answer to the question, "How redistributive are the Government's proposals?" One can ask to what extent the scheme favours the lower paid at the expense of the higher paid. One can ask how far it represents a transfer of resources in the short term from the working population to the retired—or one can ask the same question in relation to the scheme's long term effects. And, finally, one can ask to what extent it is biassed in favour of those retiring in its early years. Each of these questions, however, involves a comparison between what is now proposed and what would otherwise have occurred, and such a comparison must inevitably be based on arbitrary assumptions, since nobody can say with any assurance what would happen if the proposed new scheme were *not* introduced. Even if the immediate redistributive effect can be measured, the effect on the distribution of income in the year 2000 cannot, because there is no valid basis for comparison. When Mr Boyd-Carpenter and the *Daily Telegraph* criticise the scheme as too redistributive, they are no doubt comparing it with what they suppose a Conservative government might do. The *Guardian* and the *Economist,* on the other hand, take as their criterion the proposals put forward by the Labour Party in opposition. It is not surprising that they arrive at different conclusions.

Given these conceptual difficulties, it is hardly worth pursuing the question whether the scheme is or is not redistributive in any absolute sense. But this need not prevent us from asking whether the White Paper could reasonably have been expected to go farther than it does in transferring resources from the haves to the have nots.

how much redistribution?

The White Paper itself claims that the proportion of total personal consumption accounted for by pensioners will rise from 10 per cent to 12 per cent by the end of the century, and that this improvement in the relative standard of living of pensioners will be concentrated on the neediest groups, especially widows. Since the proportion of old people in the population is expected to fall from 15.9 per cent in 1970 to 13.6 per cent in 2000, the improvement is a real one and not merely the effect of growing numbers of pensioners. Not all of it can be placed to the credit of the new scheme, since the growth of occupational schemes would anyway result in some improvement in the relative position of pensioners. But the Government can fairly claim the credit for concentrating the improvement, in the long run, on those least adequately provided for by occupational schemes—the lower paid, who are mostly not covered at all, and widows, for whom occupational provision is notoriously inadequate.

The bias in favour of the lower paid in the pension formula goes as far as could reasonably be expected, and prob-

ably much farther than some of the Government's advisers (especially those concerned with the impact on holders of sterling) would have wished. To give over twice as much pension for every pound of contributions on earnings below half the national average as on earnings above that level is, if anything, to invite the charge of "soaking the rich". In one respect, however, the pension formula looks at first sight less favourable to the lower paid than the earlier national superannuation proposals. The 1957 scheme would have retained the basic flat rate pension, to which the earnings related element was to be added. Thus the flat rate provided a floor ; however low a man's earnings, he could be assured of this minimum pension. This aspect of the Labour scheme was taken over by the Tories, whose graduated pension scheme was merely a supplement—and a very inadequate one—to the flat rate pension. But in the new scheme, the flat rate pension will disappear. To qualify in 1992 for a pension equivalent to the £5 flat rate payable from November 1969, a single man in steady employment would have to earn £8 7s a week, or the equivalent allowing for rising average earnings, for 20 years. Hence the *Guardian's* plea for "some flat rate element in the benefits".

Closer examination of the facts shows that the abolition of the flat rate pension is not as regressive a proposal as it seems. In the first place, there cannot be many male employees earning, on average, as little as £8 7s, especially when one remembers that earnings for periods of sickness and unemployment will be "credited" at half the national average (£12 at 1969 earnings levels). Women, it is true, are far more likely to be earning this kind of wage, especially for part time work. Married women, however, do not usually qualify for a full flat rate pension in their own right under the present scheme, since most of them "opt out" of national insurance contributions. And a single woman earning £8 7s a week or less would in all probability qualify for a means tested supplementary pension on retirement, in which case her total pension would be the same whether she received the full flat rate under the present scheme or a smaller earnings related benefit under the new scheme. Women who remain single until age 60 are anyway increasingly rare, and are more likely than married women to be found among the higher paid sections of the female labour force. To regard the flat rate pension as a guaranteed minimum is in fact fallacious. It is only paid in full to those who have paid an average of 50 contributions a year, and about 5 per cent of all pensioners are at present getting less than the standard flat rate pension. It seems fair to conclude that the decision to abolish the flat rate pension is unlikely to cause any real hardship and, indeed, that many people with irregular work records may find it easier to obtain an adequate pension in a scheme which does not demand continuity of contributions through working life.

The long term effect of the scheme seems likely to be a significant improvement in the living standards of the old, compared with the rest of the population, and the improvement will be most marked among the groups least adequately provided for at present. For the present generation of pensioners, however, as we have seen, the White Paper offers no prospect of any radical improvement, though we may still hope for a change of heart on the part of the Government before 1972 (a change of government is, of course, also a possibility). But we cannot assess the redistributive effects of the scheme by looking only at the benefits. We must also consider who is to pay for them.

ways to more redistribution

We have already noted that, even without any immediate increase in the benefits, the burden of contributions borne by the low paid worker will not be substantially reduced. There are three ways in which the burden could have been shifted farther in his favour: by exacting higher contributions from employers, by a bigger exchequer contribution, or by a higher ceiling (or none) on employees' contributions.

The Government's reluctance to raise employers' contributions is understandable, given its present preoccupation with the effect of industrial costs on the balance of payments. It is by now generally accepted, moreover, that loading the major part of the cost of social security on to employers does not necessarily lead to greater equity. The question of who ultimately pays employers' contributions is difficult to answer at all precisely, but it seems certain that a large proportion of any increase will be passed on to the consumer in higher prices or, in the long run perhaps, to the worker in lower wages. The effect on both prices and wages need not be indiscriminate. The Government could, if it wished, take measures to protect the lower paid and to hold down prices of essential goods and services. The fact remains, however, that making the employer pay is not the simple socialist solution to the problem of financing social security that it was once thought to be.

If the ultimate impact of employers' contributions is difficult to predict, it is still more difficult to say out of whose pocket the Exchequer's contribution comes. One thing is clear, however, the proposed contributions are to be a fixed percentage of earnings up to the ceiling of one and a half times the national average. In comparison, a progressive tax (that is, one which represents a higher percentage on larger incomes than on smaller ones), or even a proportional (fixed percentage) tax with no ceiling, would favour the lower paid. So, for example, if part of the income to be derived from employees' contributions were instead obtained from income tax, the low paid worker would fare better. The point is worth stressing because, in the general rejoicing at the abolition of the long condemned and intensely regressive flat rate contribution, there is a risk that earnings related contributions may come to be regarded as the ideal way of financing social security.

It is worth stressing for another reason too. Although the Exchequer contribution, according to the White Paper, is to be 18 per cent of the combined contributions of insured persons and employers—about the same proportion as at present—it is likely that the real cost to the Exchequer will be less than this in the early years. The arithmetic is simple. In the first year, 1972-73, the total outgo of the proposed scheme, according to the Government Actuary's figures, will be only £16 millions more than the estimated cost of the present scheme in that year. How much extra income the new scheme contributions will produce depends on the amount of contracting out. If there were no contracting out at all, an extra £400 millions or thereabouts would be collected from insured persons and employers. Even if the actual increase in contribution income turns out to be only £100 millions, all but £16 millions of this will go into the National Superannuation Fund and thence to the Exchequer (assuming that the fund is to be invested, like the present National Insurance Fund, in Government securities), thus reducing the net cost of the scheme to the Exchequer. The Government Actuary's estimates show that, if there were no contracting out, the scheme would start with a surplus of £390 millions for the first year, while the Exchequer's contribution for that year would be £361 millions; in other words, the Exchequer would receive from the Fund more than it contributed! Allowing for contracting out, it seems certain that the Exchequer will have to bear part of the cost of the scheme, but its net contribution could well be far less than it contributes to the present scheme.

If this is so, the question which concerns us is not simply whether the Exchequer should pay more or less than 18 per cent of the combined contributions of insured persons and employers, but whether, in the likely event of the proposed contributions (including that of the Exchequer) exceeding what is required to meet the initial cost of the benefits, the "profit" should be used to reduce the Exchequer's contribution below the theoretical 18 per cent, or whether it should be used to reduce the contribution rates for insured persons and/or employers (there is, of course, another possibility—that, as suggested

above, the flat rate pension could be substantially increased, in which case the predicted surplus would presumably be absorbed by the increased cost; the present argument is based on the pessimistic assumption that this will not happen). This is, perhaps, an academic point, since the Treasury would, one may be sure, firmly veto any proposal to reduce the initial contribution rates of the other two parties. Academic or not, however, it is a point that needs to be understood if the real effect of the proposed changes is to be fully appreciated. To the extent that the new graduated contributions replace the existing flat rate contributions, they clearly favour the lower paid worker. To the extent that they relieve the Exchequer of its share of the cost, they represent a transfer from progressive (or potentially so) taxation to a proportional tax which, on earnings above one and a half times the average, is actually regressive.

a ceiling on contributions?

This brings us to the question of the ceiling. The 1957 National Superannuation scheme suggested that contributions should be levied on earnings up to four times the average wage. This would now mean nearly £100 a week or £5,000 a year. The idea of a ceiling was presented, not as a way of limiting the contribution paid by top salary earners, but as a way of preventing the payment of very high pensions by a scheme intended to reduce inequalities in old age. The maximum pension would have been about one and a half times average industrial earnings —about £36 a week at present levels.

The ceiling proposed in the White Paper is very much lower. Contributions would only be payable on earnings up to one and a half times the national average and the maximum pension for a single person, based on April 1969 earnings, would be only £13 4s. The reason for this drastic reduction in the scope of the scheme lies in the growth of occupational schemes since 1957. By limiting the State scheme to the lower range of earnings, ample scope is left for private provision and employers with schemes covering higher paid employees will be encouraged to continue them (though the encouragement is somewhat reduced by the absence of any ceiling on employers' contributions). At the same time, the State scheme will extend far enough up the income scale to provide adequate pensions for those solely dependent on this source of retirement income.

It is undeniable, however, that the lower ceiling must reduce to some extent the redistributive effect of the scheme. Since contributions on earnings above half the national average will only earn pension at the 25 per cent rate, they will help to pay for the 60 per cent pensions payable on earnings up to half the average. The higher the contribution ceiling, the bigger the "profit" available to subsidise the pensions of low paid workers (or, in the short term, to pay for an immediate increase in the flat rate pension).

What the White Paper offers is a compromise between the conflicting aims of redistribution and encouragement of private provision. At first sight, the proposed ceiling may seem disappointingly low. In fact, however, a higher ceiling would make surprisingly little difference to the finances of the scheme. As we have already noted, only 7 per cent of employees earn more than one and a half times average industrial earnings. Of those 7 per cent, probably the majority earn only a few pounds a week more. The additional contribution income that would result from a much higher ceiling would not, therefore, be of great significance relative to the total income and expenditure of the scheme, though it would result in much higher contributions by a minority of highly paid employees. Given these facts, it is hard to blame the Government for setting the ceiling where it has, unless one is also prepared to argue that the Government is wrong to encourage the continuation of private schemes in roughly their present form.

On balance, the scheme cannot be described as radically redistributive. Compared with the present situation, how-

ever, it has a distinct bias in favour of the lower paid worker. When it is fully mature, it will go a long way towards eliminating the poverty that is still the lot of so many old people in Britain. But it cannot be too strongly emphasised that "fully mature" means not merely that the youngest group of pensioners will be getting the full benefit of the scheme (the situation that will be reached in 1992), but that older pensioners will be in the same position—and this will take much longer to achieve.

5. contracting out

"Half of all employed persons, including about two thirds of all employed men, are now members of occupational pension schemes", the White Paper tells us, quoting the findings of the Government Actuary's latest survey. Of the total membership of over 12 million, 8 million are in private industry and 4 million in the public sector. If the Conservative Party can be said to have a policy on pensions, it is to foster the growth of private occupational schemes and to reduce the role of the State to a minimum. Naturally, therefore, much of the comment on the Government's proposals was concerned with comparing the benefits with those offered by private schemes in terms of value for money, and with the probable effect on occupational schemes on the new scheme's introduction.

comparing benefits

The biggest problem of presentation which the drafters of the White Paper had to solve was how to prevent misleading comparisons being made between the new scheme and those of private employers. To say that the scheme offers good or bad value for money, one must first make a realistic estimate of the probable cash value of the pension (including, where appropriate, that of the widow) both at the time when it comes into payment and thereafter; and this involves assumptions as to future increases in earnings, both those of the particular individual and the national average. The calculation is further complicated by the fact that the White Paper not only gives a definite promise of inflation proofing of pensions in payment but also offers the hope that they will rise in line with average earnings.

In the interests of intelligibility, the White Paper had to give some indication, in hard cash terms, of what the pensions offered by the scheme would actually look like when they came to be paid. It could, of course, have shown what would happen if wages rose by, say, $3\frac{1}{2}$ per cent per annum between now and the end of the century. To do so, however, would have produced figures much lower than the pensions that are in fact likely to emerge. In order to do justice to the scheme, a higher rate of wage increases would have to be assumed —but the political implications of a White Paper assuming wage increases of, say, 6 per cent per annum for the next 30 years obviously ruled out this approach.

The solution actually adopted is a stroke of genius. The White Paper does not show how much pension a man aged 45 in 1972 will receive when he retires 20 years later. Instead, it shows what a man now aged 65 would have got if the scheme had been introduced 20 years ago, and compares this with what he is actually getting today.

In one respect the comparison is slightly unfair as the figures given for the new scheme pension assume that the scheme has been in operation for 20 years, whereas the figures given for the Tory graduated pension show only the amount of pension accrued in the seven years since the scheme commenced. How-

COMPARATIVE PENSIONS AT APRIL 1968 EARNINGS LEVELS

proportion of national average earnings during working life	amount of earnings	fully mature new scheme pension*	present scheme pension: flat rate		graduated		total
	£ s	£ s	£ s		s		£ s
$\frac{1}{2}$	11 0	6 12	4 10	+	1	=	4 11
$\frac{3}{4}$	16 10	8 0	4 10	+	5	=	4 15
average	22 0	9 7	4 10	+	8	=	4 18
$1\frac{1}{4}$	27 10	10 15	4 10	+	9	=	4 19
$1\frac{1}{2}$	33 0	12 2	4 10	+	9	=	4 19

*on assumption scheme commenced in 1948.

ever, to have shown figures calculated on the same basis would have involved completely arbitrary assumptions as to the changes that might have occurred in the scheme if it had commenced thirteen years earlier.

By showing what would have happened if the new scheme had started in 1948, the White Paper, in effect, throws out a challenge to those who prefer private to State provision to show what kind of pensions an occupational scheme would have produced in return for the same contributions over the same period. The challenge has not been taken up. If it had been, the comparison would inevitably have been very much to the disadvantage of the occupational scheme, assuming that it was fully funded (and one of the main advantages claimed for private schemes is that they are "properly funded"). This is partly due to the favourable treatment given to those retiring in the early years of the new scheme. If a similar comparison were made over a period of 40 rather than 20 years, the occupational scheme would put up a better showing, provided that the comparison was limited to the initial pension paid to a man on retirement. Taking into account post-retirement pension increases in the State scheme, however, the occupational scheme would be extremely unlikely to measure up to the White Paper proposals. Such a comparison would anyway be unreal because few, if any, occupational schemes offer pension increases of the kind proposed in the White Paper—that is, inflation proofing as a minimum, with the probability of something more.

Despite the deliberate omission from the White Paper of any prediction as to the size of the pensions that would emerge 20 years ahead or more, the press insisted on making the kind of misleading comparison that this omission was intended to prevent. The attitude of some newspapers was similar to that of the Tory shadow Cabinet which, according to the *Guardian's* political correspondent (30 January 1969) was "basing its study of the plan on the *assumption* that private occupational pension schemes offer better value to the contributor than any State scheme could do" (my italics).

Both *The Times* and the *Daily Telegraph* must be exempted from this criticism. Although both ran extremely hostile leaders on the day after the White Paper's appearance, neither felt able to suggest that the scheme, judged by commercial standards, was not good value for money. The *Daily Express,* on the other hand, published (29 January 1969) a table purporting to show that anybody aged 40 or under would do better by investing in private insurance than by contributing to the Government's scheme. To produce this result, the authors of the *Express* article, Andrew Fyall and Colin Smith:

1. Quoted the pension figures from the White Paper, based on 1968 earnings levels, ignoring the fact that their examples related to men retiring between 1992 and 2007, when the State scheme will be paying pensions based on very much higher earnings;

2. Based their comparison on a fixed annual contribution, ignoring the fact that contributions would rise with the individual's earnings, and thus weighting the comparison in favour of the private scheme;

3. Compared the pensions payable at the time of retirement by the State and private schemes respectively, ignoring the fact that the State scheme offers regular pension increases after retirement;

4. Ignored the benefits for dependent wives and widows offered by the State scheme.

It is possible that Messrs Fyall and Smith were doing their best with a story neither of them understood—a situation in which journalists often find themselves. What is far more disturbing than this lapse in journalistic standards is the fact that the comparative figures showing the benefits of private insurance were supplied by "a spokesman for the giant Vehicle and General Insurance group (assets £33 million)". Did this spokesman know to what

use his figures were to be put? If he didn't know, surely he had a duty to find out, or at least to insist on the *Daily Express* publishing a correction of its grotesquely false comparison.

Henry Fielding, in the *Sun* (3 February 1969), attempted a similar exercise, but took the precaution of explaining to the insurance companies he approached what he was up to. "Frankly," he reported, "they were not very helpful. They said you could not compare the Government scheme with a straight commercial job from them." Despite this warning, he went on to quote the benefits provided by various commercial insurance policies, falling into precisely the same traps as Expressmen Fyall and Smith, and—to make the comparison still more meaningless, if that were possible—ignoring both the employers' contribution to the State scheme and the fact that a third of the total contribution will go to pay for benefits other than retirement and widows' pensions.

Mr Fielding would not pretend to be a pensions expert. Arthur Seldon, on the other hand, would certainly claim this status. Yet we find him complaining in the *Sunday Telegraph* (2 February 1969) of "the poor value most pensioners would get in the State scheme: a man of 40 could get about twice as much from the insurance companies". As Mr Seldon does not explain how he arrives at this improbable conclusion, it is impossible to say whether, like the Shadow Cabinet, he is simply *assuming* that private schemes must offer better value, or whether he too has been talking to "a spokesman for the giant Vehicle and General et cetera, et cetera, or simply reading the *Daily Express*.

The fact of the matter is, as the insurance companies admitted to Henry Fielding, that the Government's proposals cannot be compared with what occupational schemes offer. The reason why they cannot be compared is simply that the new State scheme offers benefits of a kind that occupational schemes do not and, without a very radical change in their whole financial basis, cannot provide. Why, then, should the Government be so anxious to preserve and encourage occupational schemes? Given that the State can do the job better, why should it not do the whole job? In short, is contracting out either necessary or desirable?

partial contracting out

Before attempting to answer this question, it may be helpful to explain briefly the form that contracting out is to take. This is one of the major innovations of the new scheme (but innovation, of course, is not necessarily the same thing as progress). In the past, it has always been assumed that, to be allowed to contract out of all or part of a State pension scheme, employers must be able to offer equivalent benefits in their own occupational schemes. The better the State scheme, therefore, the less contracting out there would be. The Tory graduated scheme was deliberately designed to be modest, backward looking and slow to mature, so that as many occupational schemes as possible would be able to offer equivalent pensions and thus to contract out. Labour's National Superannuation scheme, on the other hand, deliberately sets out to provide the kind of benefits that occupational schemes have shown themselves to be incapable of producing—in particular, guaranteed inflation proof pensions on retirement, with at least the possibility of increases in real value after retirement; a pension formula giving far better value to the lower paid workers; and the payment of full earnings related pensions after only 20 years. Although, ever since 1957, the Labour Party has been committed to allowing contracting out, it has never been clear how any occupational scheme would be able to measure up to the standard set by National Superannuation.

The White Paper offers an ingenious solution, which it describes as "partial contracting out". This device was, if not invented, assiduously promoted by some of the brighter elements in the insurance industry, who saw it as a way of preserving their freedom to sell the traditional non-dynamic type of pension

scheme, regardless of any improvements in the State scheme. Its adoption in the White Paper represents a major political victory for the life offices. The idea is that, instead of contracted out schemes providing similar benefits to the State scheme, they will simply offer pensions of fixed cash value, with no requirement that they should be protected from inflation or geared to the rising living standards of the community, either during the individual's working life or after his retirement, no bias in favour of the lower paid, and maximum benefits payable only to those who have contributed for the whole of their working lives. Nor will contracted out schemes have to match the generous widows' benefits offered by the State scheme. So that the pensioner should not stand to lose anything, the State will undertake to pay the whole of his pension, calculated as if he had not been contracted out at all, less the amount due to him from contracted out occupational schemes of which he has been a member. The cost of any post-retirement pension increase will be met in full by the State, the occupational scheme merely being required to continue paying a fixed amount of pension regardless of changes in the value of money or in the general level of earnings. Similarly, the State will pay the whole of the widow's pension.

A simple example will show how this would work. Suppose that two men with identical earnings records retire in 1992, and that average earnings have then risen to £50 a week. The first man, who was never contracted out, gets a pension of, say, £20 a week from the National Superannuation Fund. The second man was contracted out for a few years in the 1970s and his employer, in exchange for a reduction in contributions to the State scheme, undertook to pay him a pension of £1 a week through his occupational scheme. The value of that £1 of occupational pension may be far less when it comes to be paid in 1990 than when it was earned, in the 1970s, but the man's *total* pension will not be affected because the State will make it up to the same level as if he had not been contracted out.

Similarly, once the £1 occupational pension is in payment, the employer will not be expected to increase it if its value is eroded by inflation or if average earnings rise. Pension increases will be entirely the State's responsibility. If such increases amount to 50 per cent between 1990 and 2000, for instance, the first man's State pension will go up from £20 to £30 a week. The second man's will go up from £19 to £29, the employer's share remaining the £1 that he originally contracted to provide.

This description of "partial contracting out" is based only partly on the White Paper itself. The detailed provisions were left to be discussed with "representatives of occupational schemes and others concerned". The White Paper merely stated that contracted out employees and their employers would pay a lower percentage contribution and, as a counterpart, there would be "a deduction" from the employee's personal retirement pension. This deduction would be the amount which the occupational scheme would have to guarantee. Whether it would be determined in advance, so that the employer would know exactly how much pension he was required to provide, or whether he would be expected to provide a "dynamic" pension, tied to an index of earnings up to the time of retirement and to either a prices or earnings index thereafter was not stated. But the White Paper acknowledged the difficulty of asking employers "to take on an unknown commitment which would depend on future movements in price and earnings levels" and it seemed a reasonable assumption that they would not be required to do so. Even if contracted out schemes had to provide pensions geared to current average earnings on retirement, it was difficult to see how they could be required to match the post-retirement increases given by the State scheme, since those increases were to be decided on each occasion by the Government in the light of existing circumstances. This interpretation of the Government's intentions was soon confirmed by a document circulated by the Department of Health and Social Security to the bodies taking part in the discussions on contracting out,

which proposed that "the abatement of State pension and the pension to be guaranteed by the occupational scheme should be fixed in money terms, and should not be subject to revaluation either before or after award".

the case for private schemes

Partial contracting out, generally known in insurance circles as "abatement", would make it possible for occupational schemes to remain in possession of part of the territory which the new State scheme is designed to cover. But why should it be thought desirable that they should do so? Let us consider the reasons advanced by *The Times* (29 January 1969) for preferring to "place the emphasis on private insurance:

"Private insurance and pension schemes have to be actuarially sound; they have to be funded; they provide investment capital for industry; they provide flexible cover to suit differing personal needs; they are invested in real assets which rise in value with inflation; they avoid the creation of a new state bureaucracy and are likely to be administered with greater cost economy. State schemes are not funded, do not have real assets, do not contribute to creating the wealth from which pensions are eventually to be paid. They do not give the citizen the feeling of providing for his own future, and indeed benefits bear only the vaguest relationship to payments, and may be a bad bargain as well as a good one for the individual."

The idea that private schemes have to be "actuarially sound" was exploded as long ago as 1958 by no less an authority than the President of the Institute of Actuaries, who admitted: "I do not know a completely satisfactory definition of solvency, but even if one is assumed to exist then many schemes which are solvent on that definition at one point of time would immediately be rendered insolvent by an increase in the level of wages". Pension schemes, he continued, "are not to be regarded as a rigid railway track to a fixed destination. The target is continually shifting, mainly because of changes in wage levels, but also because of changes in mortality, interest, expense and tax. Pension schemes can therefore be more happily regarded as homing on to a distant and moving target under the guidance of the actuarial radar tracking system. Whether a scheme will be successful or not is only in part a question of where it is now: that is to say, its current degree of solvency. It is also largely a question of the power of its driving force to bring it curving on to track in due course. The main driving force is the ability of the employer to fulfil his obligations and to increase his contributions whenever necessary. Solvency is therefore often inextricably bound up with the resources of the employer" (F. M. Redington, Presidential address, *Journal of the Institute of Actuaries*, 1959, vol 85, pt I, pp5-6).

If this is what actuarial soundness amounts to, it hardly constitutes the protection that most people imagine. The right to draw an occupational pension 30 or 40 years in the future is a very insecure asset if it depends on the employer's ability to increase his contributions to whatever level the radar tracking system may require at any time in the intervening period.

We have already examined the argument that funded private schemes are superior to a pay as you go State scheme because of their effects on savings and investment, and found it to be a good deal less persuasive than might be supposed from the dogmatic tone in which it is advanced by *The Times*. Nevertheless it is an argument which demands serious attention. But instead of concentrating on this point which, on any view, has at least some substance, *The Times* proceeds to wander off into a fantasy world. Private schemes, it tells us, "provide flexible cover to suit differing personal needs". Top hat schemes for a few wealthy individuals may do this—the main "personal need" catered for by them being the need to avoid income tax. But the average employee in a firm which runs an occupational scheme is obliged to join it and offered little or no choice as to the level

or type of benefits for which he is covered. Why compulsory membership of the ICI pension scheme, for example, should "give the citizen the feeling of providing for his own future" is a profound mystery.

Private schemes, in the looking glass world inhabited by *The Times*, offer protection from inflation because they are "invested in real assets". The much surer protection from inflation offered by a pay as you go scheme is, curiously enough, omitted from *The Times*' list of characteristics of State schemes. As for benefits bearing "only the vaguest relationship to payments", if this is true of State pension schemes, it is still more true of private schemes, not only because of the extreme vagueness of the concept of actuarial solvency, but also because the employer decides unilaterally what proportion of the cost of his scheme, if any, should be borne by the employees and often does not even bother to tell them whether they are paying 10 per cent or 90 per cent of the total.

Most fantastic of all, however, is the argument that private schemes are more economical in administration. Admittedly the Government Actuary's estimate that the cost of administering the new scheme will be less than 2 per cent of the benefits is an understatement, since it leaves out the cost to employers of collecting the contributions. Even allowing for this, by commercial standards the scheme will be absurdly cheap to run. Comparisons are difficult, but it would be astonishing if a single State scheme covering the whole working population cost anything like as much to administer as the 65,000 occupational schemes which at present cover only half of all employed persons —and that half excludes most of the more mobile workers, as well as most low earners for whom administrative costs are inevitably high in relation to the size of their benefits. It is not even true that the new scheme will be more expensive to administer than the present National Insurance scheme. The White Paper predicts "a considerable net saving in employers' administrative costs" as well as in the administrative costs borne by the State, as a result of the replacement of the present dual system of flat rate and graduated contributions by a single wage related contribution.

It may seem unfair to compare occupational schemes in their present obviously unsatisfactory state with the White Paper's proposals which are not to be brought into effect until 1972 at the earliest. Occupational schemes, it may be argued, have improved over the years, and will continue to improve. The weakness of this argument is that, under the proposed contracting out arrangements, employers will have no incentive whatsoever to improve their schemes. All they will have to do is to go on providing static, fixed value (or, in real terms, diminishing) pensions of a kind which ought to have been made illegal years ago, while the State will take over the whole responsibility for ensuring that pensioners are not only protected from inflation but enabled to enjoy a steadily rising standard of living. If an employer invests his pension fund skillfully, so that it grows more rapidly than is necessary to satisfy the contracting out conditions, he may choose to increase the benefits (in which case his ex-employees' incomes will probably rise faster than average earnings) or, more probably, he will reduce his contributions to the fund. The basic job of keeping pensions in line with rising living standards, however, will be taken out of the employer's hands altogether, except insofar as his scheme is built on top of the State scheme rather than merely providing a substitute for part of it.

Contracting out, therefore, should not be seen as a way of raising standards of retirement provision, but simply as a way of ensuring that most private schemes remain in existence, albeit on a reduced scale in some cases.

fixing the price

There are two major questions to be resolved in the discussions between the Government and the various interests concerned which are now at an advanced

stage. These are, first, how big a reduction in contributions will be conceded to contracted out employees and their employers and, secondly, how much pension the employer will have to provide as the counterpart of this reduction.

The size of the reduction or abatement of contributions is crucial, not only for occupational schemes but, still more, for the State scheme. Given that the object of the contracting out arrangements is to leave enough scope for most occupational schemes to continue operating on something like their present scale, there is a good case for allowing them to provide as large a proportion of the total pension as possible. Contracting out, however, means that contributions which would have been available immediately to finance State pensions on a pay as you go basis will instead be invested in occupational schemes to finance private pensions at some time in the future. It is true that there will be a corresponding reduction in the future liabilities of the State scheme so that, in the very long run, its finances may not be adversely affected; but in the short run, if large numbers of employees are contracted out, and particularly if they are excused a large proportion of the contributions they would otherwise pay to the State scheme, the effect on the financial balance of the scheme could be very serious. The Government Actuary estimates that, if there were no contracting out at all and no increase in the flat rate pension beyond that required to maintain its value relative to average earnings, the new scheme would produce an annual surplus for about 15 years; but if the $5\frac{1}{4}$ million employees contracted out of the present graduated scheme were also contracted out of the new scheme, "each $\frac{1}{4}$ per cent a side reduction in the contributions would reduce the period of growth of the fund by about one and a half years". For example, if contracted out employees paid $3\frac{3}{4}$ per cent instead of $4\frac{3}{4}$ per cent of their earnings to the National Superannuation Fund, and their employers' contributions were similarly reduced, the income of the Fund would exceed its expenditure for only about nine years instead of fifteen, and the contribution rates would have to be increased in 1981 instead of 1987. If the numbers contracted out rose from $5\frac{1}{4}$ million to 8 million, the fund would show an annual surplus for only about five years, while an abatement of $1\frac{1}{2}$ per cent rather than 1 per cent per side, with 8 million contracted out, would mean that the scheme would be in the red almost from the start. To allow contracting out to deprive the National Superannuation Fund of a substantial part of its potential income in this way would not only rule out the possibility of a worthwhile improvement in the flat rate pension in 1972, it would also have an effect on the two yearly reviews of benefit rates, making it more difficult to achieve the aim of raising benefits in line with average earnings.

Another factor limiting the possible area of contracting out is the redistributive element in the pension formula. The Life Offices' Association made it clear, in a statement commenting on the White Paper, that the insurance companies are not interested in taking over the preferential rates of pension payable to lower paid workers, nor the abnormally speedy build up of pension rights in the first few decades of the scheme. The part of the scheme they are interested in is the pension of $36\frac{2}{3}$ per cent of earnings (roughly 0.8 per cent for each year of employment) which a man at the scheme's ceiling (one and a half times average earnings) would get in exchange for contributions over his full working life. Since those with lower earnings would get a pension of between $36\frac{2}{3}$ per cent and 60 per cent, contracted out schemes could undertake to provide a $36\frac{2}{3}$ per cent pension for everybody, up to the ceiling, leaving the balance of up to $23\frac{1}{3}$ per cent to be paid by the State.

The first "consultative document", issued by the Department of Health and Social Security as a basis for discussion of the terms for contracting out, came to a broadly similar conclusion as to the amount of pension that could be left for occupational schemes to provide. It also pointed out that a larger abatement of pension could mean that some pension-

ers would receive a smaller State pension than they would get under the present scheme, with the result that their total pension rights might be reduced unless their employers' schemes were expanded.

A second "consultative document" put forward the Government's views on the reduction of contributions that could be offered to those contracted out: "On a balance of the factors involved, a fair contribution abatement at the outset of the new scheme for a pension abatement of 0.8 per cent of earnings would be likely to lie in the region of 1 per cent a side of the employee's reckonable earnings up to the scheme's earnings ceiling". If one per cent a side seems a small contribution abatement in relation to the proportion of the total pension to be provided by the occupational scheme, it should be remembered that the occupational pension will not be linked to average earnings but fixed in cash terms with no post-retirement increases. Nor will it include any addition for a dependent wife or provision for widowhood. Even if the fullest possible scope is left for contracting out, by fixing the pension abatement at 0.8 per cent of earnings per year, it will still represent a relatively small proportion of the total benefits, especially during the abnormally rapid build up of pension rights up to 1992.

The Life Offices, however, seemed to be thinking (at least as an initial negotiating position) in terms of a much bigger contribution abatement than 1 per cent a side. The *Daily Telegraph's* City Editor (30 January 1969), suggested that the abatement, if contracted out schemes were to provide 36¾ per cent pensions, might be 2 per cent per side—a figure also quoted by the *Economist*. How and by whom this figure was arrived at is not clear, but it would hardly be surprising if a representative of the Life Offices had discreetly suggested it to one or two friendly journalists. At all events, three months later, when Richard Crossman, in a speech at Watford, appeared to be suggesting that a reduction of one and a half per cent per side might be more than the Fund could stand, Mr Gordon Bayley, Chairman of the Life Offices' Association, reacted with the statement that one and a half per cent was "peanuts" and that, if the Fund was in danger of going into the red, the Government should increase its contribution.

Subsequent statements by both the Life Offices' Association and the National Association of Pension Funds (NAPF), however, were more moderate both in tone and in content. The NAPF reported in July that about half its members would be satisfied with a contribution abatement of not less than 1.2 per cent in relation to a 0.8 per cent pension abatement. At about the same time the Life Offices' Association not only conceded that a contribution abatement of one and a half per cent would be "sufficient to encourage employers and employees generally to undertake the administrative complications of contracting out", but even admitted that the pension abatement corresponding to such a reduction of contributions would be more than 0.8 per cent—perhaps as much as one per cent.

There is therefore a reasonable prospect of the Government producing a contracting out formula broadly acceptable to the occupational pension interests and generous enough to encourage a large volume of contracting out. The danger in this situation is that the terms will prove to be too generous for the health of the new State scheme. This danger is inherent in the basis on which the discussions have been conducted. The White Paper placed the Government in a weak bargaining position by saying that the contribution abatement, for employer and employee together, would represent the "commercial" cost of the pension to be provided by the occupational scheme. In other words, the Government was prepared, in effect, to buy pensions from the private sector at the price that an employer would have to pay an insurance company. But is this the right price?

To calculate the insurance premiums on a policy providing a deferred annuity in fixed cash terms (which is what the

contracted out pension will be) involves making assumptions about inflation and its effects on investment yields. The more rapidly the value of money falls, the more cheaply it should be possible to provide an annuity of a fixed cash amount, simply because the insurance company's investments should roughly maintain their real value in a period of inflation, while the real value of the annuity will fall. Economic growth produces much the same effect, raising investment yields and thus enabling an annuity of a given amount to be purchased by lower premiums. These two factors, economic growth and inflation, are thus essential elements in determining the "commercial" cost of a given pension. Insurance companies, being prudent financial institutions, naturally err on the side of safety in guessing what their combined effect will be over a period of several decades. As a result the premiums they demand (that is the commercial cost of the pension) are inevitably higher than would be required on a more balanced view of probable future economic trends. This tendency to over charge does not show up in the insurance companies' profits but in their accumulated reserves which, in respect of policies of this kind, are far greater than is likely to prove necessary.

By agreeing in advance to pay the commercial price for the pensions to be provided by contracted out schemes, the Government has ensured that whatever agreement is reached with the occupational pension interests will be a bad deal for the general body of contributors. All the more reason, therefore, why not only the terms of contracting out, but the way in which they are arrived at should be made public. At the very least, a White Paper should be published showing how the proposed contribution abatement compares with the "commercial" cost of the pension to be provided and explaining any discrepancy. Details should also be given of the actuarial assumptions on which the commercial cost is based—especially the assumptions regarding investment yields. This is a major political decision whose results will extend over a very long period of time and which ought to be clearly explained and understood.

conclusion

The Government's proposals for a new National Superannuation scheme undeniably represent a very considerable advance on the present national insurance scheme. But it is twelve years since proposals for a reform of this kind were first put forward by the Labour Party, and what was once a pioneering scheme will now do little more than bring Britain into line with our European neighbours in the provision made for income maintenance in retirement.

In one crucial respect—the treatment of existing pensioners and those becoming pensioners in the early years—the Government's intentions, so far as they can be deduced from the White Paper, fall seriously short of the 1957 proposals; but there is still time for a change of heart on this point.

In other respects—especially the new deal for women—the scheme has clearly been worked out with great care and genuine concern to improve the situation of the neediest sections of the aged population, while at the same time offering the average worker a decent standard of living in retirement.

The one innovation which gives serious grounds for anxiety is the proposal for "partial contracting out". It has very little to do with the desire to provide better pensions, and is mainly the result of political and economic considerations far removed from the problems of provision for old age as such. Its impact on the scheme and its implications for the future development of occupational schemes therefore need to be watched with the greatest care.

Decisions are in the process of being made which will affect living standards of retired people for generations ahead. This study of the Government's proposals has been written in the belief that these decisions ought to be taken openly

and with the broadest possible understanding of their consequences. There is little time left for public discussion of the White Paper's proposals. What time there is must be used to the full.

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